FILE COPY

FEB 5 1937
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 563.

PARK L. HOFFMAN, Substituted for R. G. Holsing, Receiver of FIRST NATIONAL BANK OF BOSWELL, Pennsylvania, *Petitioner,*

v.

HENRY I. RAUCH, Administrator, EMILINE B. RAUCH, late of Jenner Township, Somerset County, Pennsylvania, *Respondent.*

BRIEF OF PETITIONER.

GEORGE P. BARSE,
JOHN F. ANDERSON,
Attorneys for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

INDEX.

Subject Index.

	Page
I. Opinions Below	1
II. Jurisdiction	2
III. Statement of the Case	2
IV. Specification of Errors	3
V. Summary of Argument	4
VI. Argument	4
VII. Conclusion	11
Appendix	12

CASES CITED.

Adams v. Champion, 294 U. S. 231	5
Blakey v. Brinson, 286 U. S. 254, 263	5
Cook County National Bank v. United States, 107 U. S. 445, 450	4
Gwynn v. Spurway, 28 Fed. (2nd) 37	9
Jennings v. U. S. F. & G. Co., 294 U. S. 216, 224, 225	6
Kohler v. Spurway, 28 Fed. (2nd) 36	8
Marchant v. Summers, 79 Fed. (2nd) 877	8
Old Company's Lehigh v. Meeker, 294 U. S. 227, 230	10
O'Neal v. White, 79 Fed. (2nd) 835, certiorari denied 297 U. S. 706	8
Texas & Pacific Railway v. Pottorff, 291 U. S. 245, 261, note 19	5, 6

STATUTES.

Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. Title 28, Section 347)	2
Section 5236 U. S. R. S. (U. S. C. Title 12, Ch. 2, Sec. 194)	4
Columbia Law Review, June 1921, Page 525	5

IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 563.

PARK L. HOFFMAN, Substituted for R. G. Holsing, Receiver of FIRST NATIONAL BANK OF BOSWELL, Pennsylvania, *Petitioner,*

v.

HENRY I. RAUCH, Administrator, EMILINE B. RAUCH, late of Jenner Township, Somerset County, Pennsylvania, *Respondent.*

BRIEF OF PETITIONER.

I.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Third Circuit (Davis, Circuit Judge) is reported in 85 Fed. (2nd) 1000 and appears in the record at page 33. The opinion and decree of the District Court are set out in the record at pages 27 and 28 and are unreported.

II.

Jurisdiction.

An order allowing the petition for a writ of certiorari was granted by this court on January 11, 1937 (R. 39) under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. Title 28, Section 347).

III.

Statement of the Case.

A trust has been impressed on the assets of a National bank in the hands of a Receiver for the proceeds of bonds held in safekeeping for one customer and sold by the bank five days prior to suspension to another customer, apparently without intent to defraud, in that substitute bonds were immediately ordered by the bank. The record establishes that the sale proceeds consisted only of bookkeeping entries in the form of a charge against a general deposit acccount in the same bank. The question is whether the trust may be upheld.

There is no material contradiction as to the facts. The First National Bank of Boswell, Pennsylvania, was declared insolvent on January 26, 1932 (R. 9, 27) and a Receiver was appointed by the Comptroller of the Currency on February 9, 1932 (R. 6). On January 21, 1932 the bank's cashier sold four Liberty bonds of the total par value of $400 held by it in safekeeping for Mrs. Emiline B. Rauch, to Josiah or Rose Lohr, depositors of said bank and charged their account with the sum of $400.24 as the purchase price of said bonds (R. 20). On the next day the bank's cashier mailed its check in the amount of $402.08 to a broker for the purchase of four similar bonds but the purchase was not completed prior to the bank's suspension (R. 20). Mrs. Rauch died June 2, 1932 (R. 3, 17, 27) and not "January 2, 1932, nineteen days before the cashier sold the bonds", as inadvertently stated in the opinion below (R.

34) and the respondent is the administrator of her estate (R. 3). The Receiver offered the respondent a general claim in the amount of $402.08 which was rejected (R. 21 and 25). The respondent then sued the Receiver at law in the Court of Common Pleas of Somerset County, Pennsylvania (R. 3) and the Receiver removed the case to the United States District Court for the Western District of Pennsylvania (R. 7) which instructed the jury to render a verdict for the respondent in the sum of $402.08 (R. 21). Thereafter, in the same proceeding, on motion for rule (R. 23) and the Receiver's answer thereto (R. 24) wherein he denied (1) that the bank's assets were augmented, (2) that the proceeds are traceable to the Receiver and (3) that the respondent is entitled to any priority over general creditors, the District Court allowed the respondent a "preferred creditor" claim in the amount of $402.08 against all of the assets that passed to the Receiver (R. 27, 28). The District Court's judgment was affirmed by the Circuit Court of Appeals (R. 38).

IV.

Specification of Errors.

(a) The Circuit Court of Appeals erred in holding that the assets of the bank were augmented by the sale of the decedent's bonds. The record establishes that the bank received no new money but merely a transfer of bookkeeping credits already on its books, incident to their sale and surrender.

(b) The Circuit Court of Appeals erred in holding that the proceeds from the bank's sale of the decedent's bonds are traceable into the hands of the Receiver.

(c) The Circuit Court of Appeals erred in impressing a trust in any amount on the assets that passed to the Receiver.

(d) The Circuit Court of Appeals erred in not requiring the respondent to participate in the pro rata distribution provided by the National Bank Act.

V.

Summary of Argument.

Where, as in the instant case, a claimant seeks to recover from the Receiver of an insolvent National bank, money or property alleged to have been held by the bank on a trust he must affirmatively establish, under the settled Federal rule: (1) that the transactions with the bank relied upon by the claimant resulted in a trust relationship between the bank and claimant (2) that the assets of the bank were augmented or increased by new cash or property accruing from said transactions, and (3) that said new property, in its original or changed form, can be traced into the assets taken over by the Receiver. No augmentation occurred and consequently no tracing is possible, where the transaction resulted only in a shifting of bookkeeping credits on the books of the now insolvent National bank.

In the instant case the relationship of bailor and bailee was terminated five days prior to the bank's suspension when it exchanged the decedent's bonds for a bookkeeping credit then on its books. When the bank surrendered the bonds it no longer held any property in trust but had a mere personal obligation to the beneficiary for a breach of trust which results in a general claim only against the Receiver.

VI.

Argument.

Section 5236 U. S. R. S. (12 U. S. C. Ch. 2, Sec. 194) (App. p. 12) "provides for a distribution of the entire assets of the bank, giving no preference to any claim except for moneys to reimburse the United States for advances in redeeming the notes." *Cook County National Bank* v. *United States*, 107 U. S. 445, 450. With this, and two other exceptions, all of minor importance and not applicable here, even the United States, the States and their political subdivisions, must participate in the pro rata distribution unless they have taken the security provided by law.

The respondent can avoid participation in the statutory distribution only upon affirmative proof that the decedent's property, held by the bank as a bailment, passed in its original or changed form into the hands of the Receiver. The rule was stated by this court in *Texas & Pacific Railway* v. *Pottorff*, 291 U. S. 245, 261, note 19 as follows:

> "The claimant has the burden of identifying the property in its original or altered form. Schuyler v. Littlefield, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged. Wuerpel v. Trust Co., 238 Fed. 269, 272-3; Knauth v. Knight, 255 Fed. 677; State Bank of Winfield v. Alva Security Bank, 232 Fed. 847; In re See, 209 Fed. 172; In re Dorr, 196 Fed. 292; City Bank v. Blackmore, 75 Fed. 771; compare Railway v. Spiller, 274 U. S. 304, 311; Cunningham v. Brown, 265 U. S. 1."

We submit that an application of the above rule to the record facts in this case establishes the error of the decision of the court below. The respondent cannot identify the Liberty Bonds, in their original or altered form, in the hands of the Receiver because when the bonds passed from the bank, "debts were discharged" and nothing more.

"The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it." *Blakey* v. *Brinson*, 286 U. S. 254, 263. "The very essence of the right of priority over other creditors depends upon the setting apart of a particular fund for the benefit of the depositor. There is no basis for giving one depositor a priority over another unless this is an essential part of the transaction." Mr. Justice Stone, "Legal Problems in the Transmission of funds." Columbia Law Review June 1921. Page 525.

The principles applied by this Court in disposing of the claim based on the Veesaert bonds in *Adams* v. *Champion*, 294 U. S. 231 when applied to the facts in the instant case

require the respondent to participate in the pro rata distribution and, we submit, the statement in the opinion of the court below (R. 36) that the cases can be distinguished is at least to this extent, incorrect. The Veesaert bonds and the bonds in the instant case were held by the banks in trust and were disposed of by the banks prior to their suspension. For the Veesaert bonds the bank received a solvent credit of $1,597.31 with a Chicago bank but as only $776.57 was admittedly traced to the Receiver this court denied the trust sought to be impressed for the remainder of $820.74 (page 239). The bonds in the instant case were surrendered by the bank in exchange for a transfer of bookkeeping credits and consequently the entire trust claim fails because of the inability to prove either augmentation or tracing of funds.

We submit that the decisions of both courts below in the instant case must be classified with the non-conforming cases referred to in this court's opinion in *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216, 225 where it said: "Decisions of other courts, to the extent that they give support for a different conclusion are built, as we think, upon an inadequate analysis, and do not win our approval."

The Appellate Court said in its opinion in the instant case (R. 37):

> "With the District Judge, we think that the proceeds of these bonds augmented the assets of the bank. They certainly reduced its liability to others."

The error of this conclusion seems to be clearly established by the excerpt quoted from this court's opinion in *Texas & Pacific Railway* v. *Potorff*, *supra*, page 5, and the following excerpt from this court's opinion in *Jennings* v. *U. S. F. & G. Co.*, *supra*, pages 224, 225:

> "But the situation is very different when what has been received by the collecting agent is not a thing at all, but a reduction of liabilities by set-off or release. Blakey v. Brinson, supra; People v. Merchants & Me-

chanics Bank, 78 N. Y. 269, 272, 273; Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Company, supra, p. 187; City Bank v. Blackmore, 75 Fed. 771; Anheuser-Busch Brewing Association v. Clayton, 56 Fed. 759; Farmers National Bank v. Pribble, 15 Fed. (2nd) 175, 176; Dickson v. First National Bank, 26 Fed. (2nd) 411; Schilling v. Rowe, 64 Fed. (2nd) 188, 190; Allied Mills v. Horton, 65 Fed. (2nd) 708, 710; Smith v. Zemurray, 69 Fed. (2nd) 5, 6, 7; First National Bank of St. Petersburg v. Miami, 69 Fed. (2nd), 346; Wisdom v. Keen, 69 Fed. (2nd) 349. *A debt does not furnish a continuum upon which a trust can be imposed after cancellation or extinguishment has put the debt out of existence.*

"The truth of this statement, though obvious enough upon its face, finds point and confirmation when the benefit, if any, accruing to the debtor is viewed as of the time of insolvency or later. What was done by the collecting bank through a settlement in the clearing house has not increased the assets available for distribution in the hands of the receiver. What was done through that settlement has had no effect after insolvency except to diminish liabilities. The dividend that would be due upon the debts canceled through the set off if they were now to be revived is the measure of any benefit accruing to the creditors. Decisions of other courts to the extent that they give support for a different conclusion are built, as we think, upon an inadequate analysis, and do not win our approval. *It is the benefit to the creditors, not the loss to the respondent, that marks the gain to the fund now held by the receiver. If the respondent is permitted to prove against the assets on a parity with other creditors, the share thus allotted will correspond accurately to whatever accretion has resulted* from the act of set off and cancellation in the operations of the clearing house." (Italics ours.)

Many decisions of Circuit Courts of Appeal can be cited in conflict with the decision of the court below, including the decisions of the Fifth, Sixth, Seventh, Eighth and Ninth Circuits cited by this court in the excerpt just quoted. The

clear conflict of the decision of the court below with the decisions of other Circuits is best illustrated by a comparison with the recent opinion of the Circuit Court of Appeals for the Fourth Circuit (Parker, C. J.) in *O'Neal* v. *White*, 79 Fed. (2nd) 835, certiorari denied 297 U. S. 706, wherein the controlling facts are almost identical and the bonds converted were the property of an incompetent World War veteran. To quote from Judge Parker's opinion (p. 835):

> "This is a suit to declare assets in the hands of the receiver of a failed National bank subject to a trust, because of the sale by the bank of *certain bonds which it held in trust for plaintiff*. It is stipulated that the bank received in payment of the bonds checks drawn by two of its customers on their accounts with it; and there is no showing that its assets were augmented in this or in any other way as a result of the conversion and sale of the bonds. The checks of the customers of the bank received in payment of the bonds resulted in a mere shifting of credits on the books of the bank, and nothing more; and this is not an augmentation of the bank's assets. *It is well settled that, in such case, a trust will not be declared with respect to the assets in the hands of the receiver.* Spradlin v. Royal Mfg. Co. (C. C. A. 4th) 73 Fed. (2nd) 776; Lifsey v. Goodyear Tire & Rubber Co. (C. C. A. 4th) 67 Fed. (2nd) 82; Harmer v. Rendleman (C. C. A. 4th) 64 Fed. (2nd) 442." (Italics ours.)

The claimant advanced substantially the same contentions in said case as were relied upon by the claimant and the Courts below in support of a preferred claim in the instant case. Judge Parker discussed and rejected these theories and reversed the District Court's allowance of a trust claim against the assets taken over by the Receiver.

On the same day the Circuit Court of Appeals for the Fourth Circuit decided another Liberty Bond case, *Marchant* v. *Summers*, 79 Fed. (2nd) 877, with a dissenting opinion by Judge Northcott. The majority opinion by Judge Parker sets out many authorities discussing the rights of the parties in these transactions including *Kohler*

v. *Spurway*, 28 Fed. (2nd) 36 and *Gwynn* v. *Spurway*, 28 Fed. (2nd) 37.

We have little complaint against the following statement of the rights of the parties quoted from the opinion of the court below, pages 1001, 1002:

> "Mrs. Rauch simply left the bonds with the bank 'for safe keeping only.' The bank was the mere custodian of the bonds, and title to them never passed to the bank. Mrs. Rauch or the administrator of her estate had the right to follow them in the original, or in some other substituted, form. The right of the administrator to pursue the bonds, or the money into which they had been converted into the hands of the receiver of the bank, depends upon the fact that title to the bonds, or the money representing them, was in the administrator, and not upon the relation of debtor and creditor, or upon the ground of a debt due and owing, Cox v. St. Anthony Bank & T. Co., 41 Idaho, 776, 242 P. 785; Windstanley v. Second Nat. Bank, 13 Ind. App. 544, 41 N. E. 946; Andrew v. State Bank, 205 Iowa 1064, 217 N. W. 250, or of compensation for the loss of property, Myers v. Matusek, 98 Fla. 1126, 125 So. 360; Daughtry v. International Bank, 18 N. M. 119, 134 P. 220, or on the ground of unlawful conversion of property, Hanover Nat. Bank v. Thomas, 217 Ala. 494, 117 So. 42; Holdbrook Irr. Dist. v. First State Bank, 84 Colo. 157, 268 P. 523. Title never passed to the bank. The administrator is merely seeking to recover his own property or the proceeds thereof, and it is the duty of the court to lend its aid to the owner in reclaiming his property."

Applying these principles to the record facts it is clear that the administrator cannot trace the bonds in their original or changed form to the Receiver. The court speaks of "the bonds or the money into which they have been converted." The difficulty in this case is that the bonds were never converted into money but were exchanged for a bookkeeping credit. Nor do we disagree with the further statement in the court's opinion at page 1002 "There is no question about the facts in this case nor about the fact that the

bonds were sold * * *." Our complaint is against the remaining language of the sentence wherein the court states "that the proceeds went into the funds of the bank, where they still remain in the possession of the Receiver." Nothing in the Federal decisions cited by the court below suggests that a trust res continues after, as in the instant case, it has been exchanged for a credit balance already on the books of the bank which formerly held the trust res or that a tracing of the proceeds to the Receiver is possible under such circumstances.

Assuming it may be suggested (in opposition) that augmentation occurred at the moment the officer of the bank wrongfully appropriated the bonds of Mrs. Rauch for the purpose of selling them to Josiah and/or Rose Lohr, it nevertheless clearly appears that the proceeds derived by the bank from the sale of said bonds are not in a form to admit of tracing an identifiable and recoverable res in the hands of the Receiver, inasmuch as said proceeds consisted only of an exchange of bookkeeping credits which, of course, did not constitute an augmentation of the bank's assets nor a basis of tracing assets to the receiver.

What the bank in substance did was to pay or discharge the depositary debt it owed the Lohrs to the extent of the agreed sale price of the bonds by selling to the Lohrs the bonds of the claimant and entering a corresponding charge against their deposit account. As previously indicated the discharge of a liability is *not* tantamount or equivalent to augmentation of assets.

This is not a case of theft or intended fraud but is one wherein an officer of the bank, without authority from its Board of Directors, undertook innocently to accommodate a customer of the bank who sought to buy Liberty bonds, it being the intent to purchase similar bonds in substitution immediately, as indicated by the act of the officer, *the next day* in sending the broker a cashier's check for that purpose (R. 20). A breach of trust was committed but, as indicated in *Old Company's Lehigh* v. *Meeker*, 294 U. S. 227, 230,

> "If this be so, the wrong does not avail to charge a trust upon the assets whereby the plaintiff will have a preference over the creditors at large. A cause of action for damages may exist, upon which the plaintiff, making proper proof, will be entitled to a dividend."

The record establishes that the bank Receiver has always been willing to accept such a claim (R. 21, 25).

VII.

Conclusion.

It is believed that the foregoing discussion establishes that the decision of the court below is in conflict with the decisions of this court and with the decisions of other Circuit Courts of Appeal; that no trust can be impressed upon the assets of the bank that passed to the Receiver; that the decision of the court below should be reversed and the respondent required to participate in the pro rata distribution provided by law.

Respectfully submitted,

GEORGE P. BARSE,
JOHN F. ANDERSON,
Attorneys for Petitioner.

APPENDIX.

TITLE 12 U. S. C. A., Sec. 194.

DIVIDENDS ON ADJUSTED CLAIMS; DISTRIBUTION OF ASSETS.

From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. 5236.)